Corporate Tax Planning: A Race to the Bottom?

Federalism at Risk

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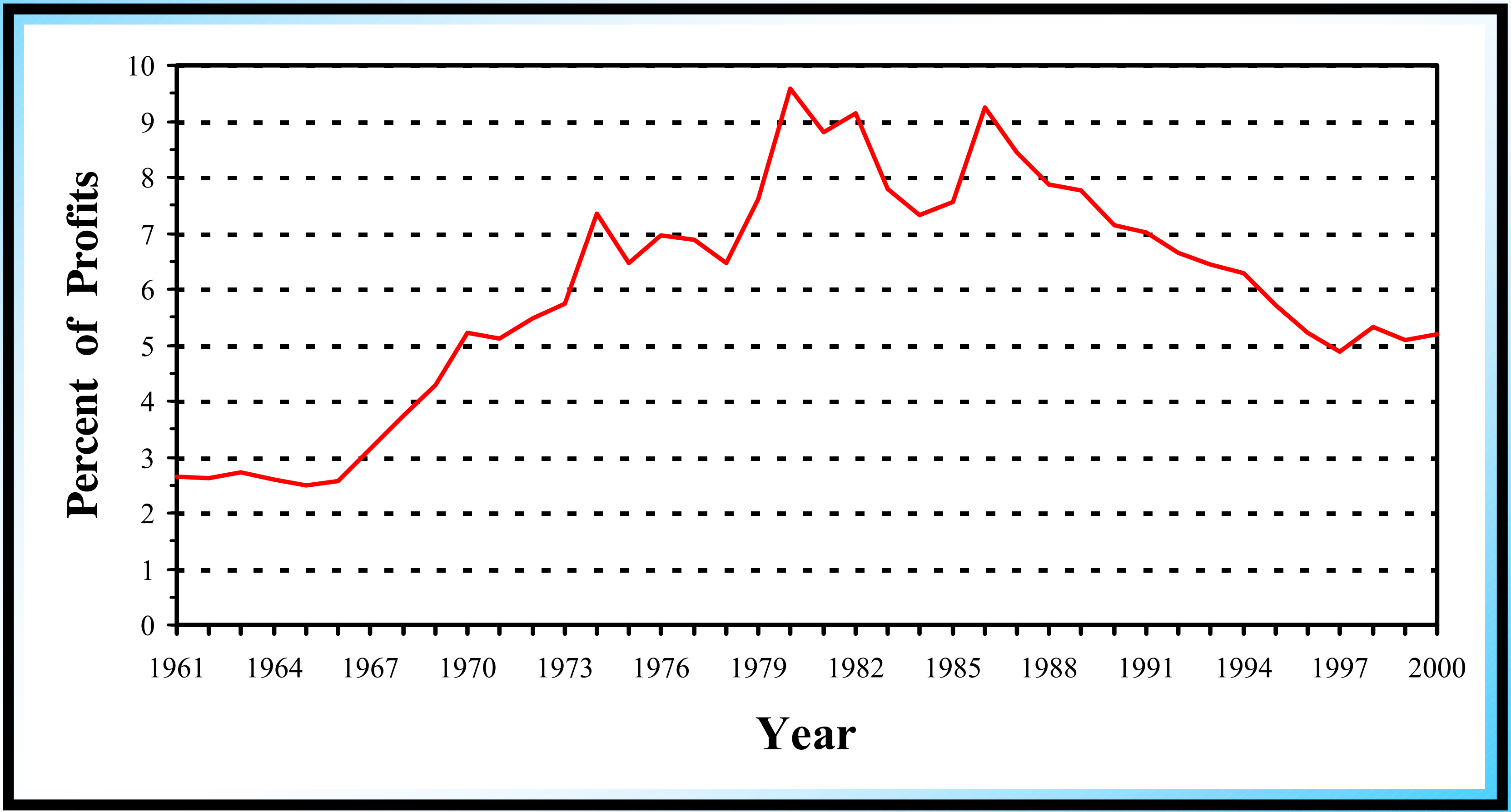
Multistate Tax Commission

Evidence of Excessive Tax Planning

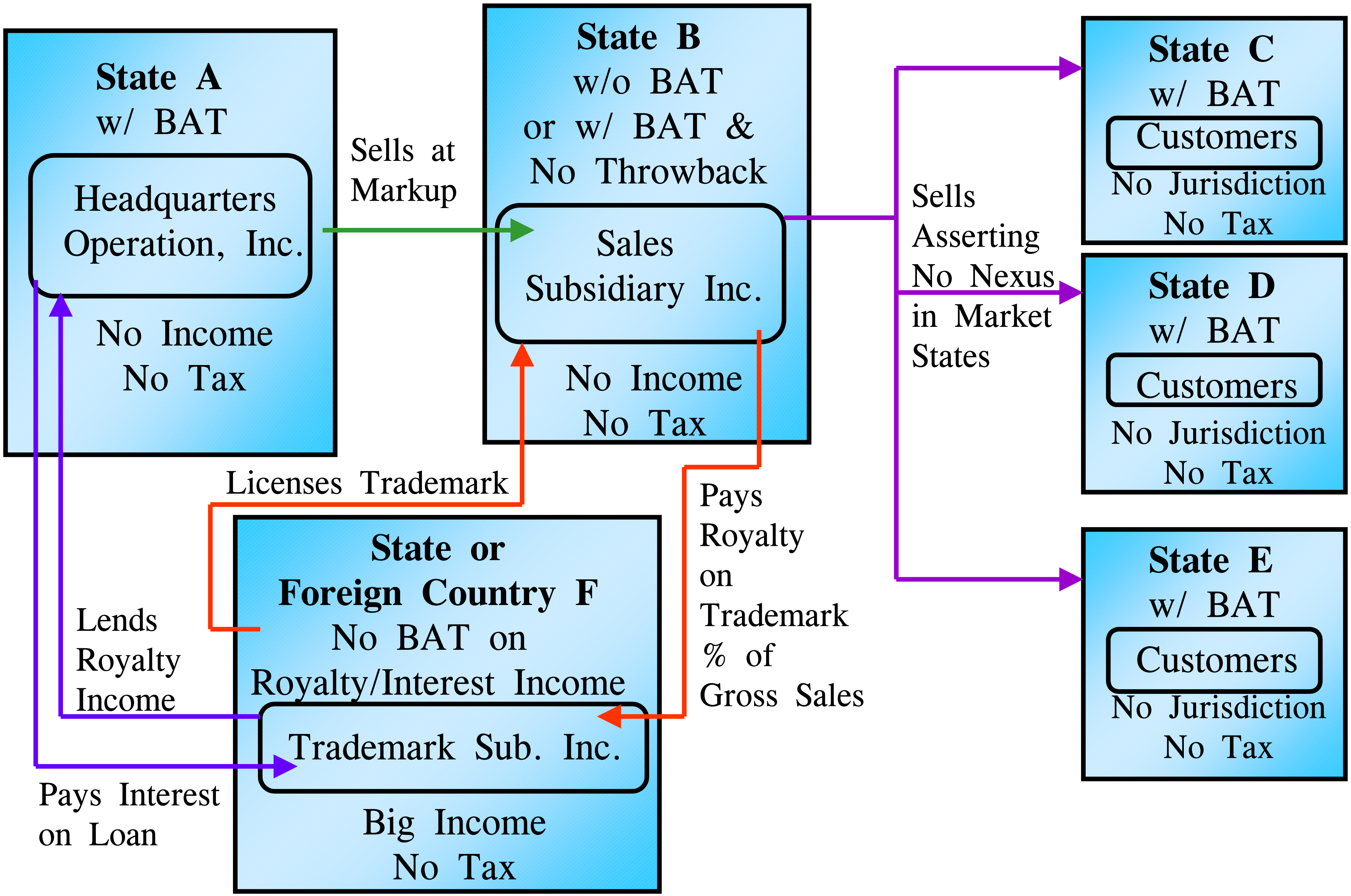
- State corporate tax effective rates have fallen since mid-80’s to a degree unaccounted for by declines in statutory rates.
- Published tax cases reveal widespread corporate tax planning.
- Audit case knowledge confirms published case record on tax planning.

State and Local Corporate Profits Tax Accruals as Percent of Domestic Corporate Profits: 1961 to 2000



Source: U.S. Bureau of Economic Analysis and Multistate Tax Commission

Tax Avoidance 102



Tax Planning Tools

- “Slice and Dice” Corporate Structure to Shift Income and/or Minimize Tax Exposure
- Reassign Assets (Especially Intangibles) within Structure
- Modify Transfer Prices
- Lobby and Litigate for Public Policies that Allow Greater Tax Planning

Problems Caused by Excessive Corporate Tax Planning

- Unfair to Individuals and Local Businesses
- Creates Inequities among Competing Multistate/Multinational Businesses with Negative Consequences for the Economy
- Undermines the Tax System by Encouraging Greater Non-Compliance

Unequal Standards of Accountability

- Corporations are less accountable for their income than individuals because they can engage in international and domestic income shifting unavailable to most citizens.
- Corporations enjoy the rights of individuals and should be held to the same standards of accountability.

Inequitable Distribution of Cost of Services

- Excessive tax planning by businesses engaged in interstate commerce allows those businesses to avoid paying a fair share of costs of the services from which they benefit.
- Residents of a State may be unwilling to pay for services perceived as of primary benefit to corporations engaged in interstate commerce.

Inequities among Businesses

- Aggressive tax planning increases variations in effective tax rates among corporations, distorts the allocation of capital and hurts the economy overall.
- Policies that allow excessive tax planning reward taxpayers that take higher risks of non-compliance and penalize the more prudent taxpayer.

Undermining Compliance

- The knowledge that corporate taxpayers can shift income to avoid taxes creates a sense of unfairness among taxpayers at large.
- One consequence of this sense of unfairness is increased non-compliance by some citizens.

Public Policies that Encourage Excessive Tax Planning

- Permission for contingency fee tax planning
- Physical activity standards of nexus
- Separate entity tax accounting
- Inconsistent and obsolete rules for dividing income among jurisdictions
- Inadequate administrative systems and enforcement practices
- Absence of adequate public knowledge of tax system and its results

Guiding Principles for Business Tax Policies

- Public policies should require full accountability of income in reasonable relationship to where it was earned.
- Public policies should continue to recognize that business income is earned in locations of both supply and demand—the economic wisdom underlying three factor formula and doing business jurisdiction.

Guiding Principles for Business Tax Policies

- Public policies should distribute the tax base among jurisdictions in an equitable manner reflecting the benefits of public services to the earning of income.
- Tax rules should be as clear and certain as possible and administrative requirements should be as efficient and convenient as possible.
- Public policy should recognize that certainty in taxation means minimizing tax avoidance.

Curbing Tax Planning: Policy Questions to Consider

- How can the “doing business” standard of jurisdiction be simplified and clarified for taxpayers?
- How can States prevent federal legislation imposing new “physical activity” limits on their jurisdiction that would legalize more tax planning?
- Are the “temporary” P.L. 86-272 rules a source of tax inequities?

Curbing Tax Planning: Policy Questions to Consider

- Is there a constituency for encouraging the federal government to move to apportionment and combined reporting methods to curb international income shifting?
- Is there a constituency for expanding uniform, combined reporting among the States?

Curbing Tax Planning: Policy Questions to Consider

- How can greater consistency in division of income rules be encouraged among the States?

- How can economically obsolete division of income rules be replaced?

Curbing Tax Planning: Policy Questions to Consider

- Should States follow federal precedent and limit contingency fee tax planning?
- How can equitable State administration and enforcement of income reporting by corporations be improved?
- Could the federal government provide enforcement assistance to States as promised in the 1980's?

Curbing Tax Planning: Policy Questions to Consider

- How can public knowledge and understanding of tax avoidance and its remedies be improved?
- Is there a viable political strategy for curbing excessive tax planning and restoring equity to business income taxation?